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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 17

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

LELAND POWERS, EXECUTOR, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS

I. OPINIONS BELOW.

The decision of the Board of Tax Appeals (R. 17) and the opinion of the Circuit Court of Appeals (R. 57) are reported respectively in 26 B.T.A. 1381 and 68 F. (2d) 634.

II. JURISDICTION OF THIS COURT.

The case comes before this Court upon writ of certiorari granted May 14, 1934 (R. 61) under Sec. 240 (a) of the Judicial Code as amended by Act of February 13, 1925.

III. STATEMENT.

The statement in the petitioner's Brief purports to be a summary of "the facts as found by the Board of

Tax Appeals," but most of it is the petitioner's own resumé of certain provisions of the Massachusetts statute—Special Acts, 1918, Chapter 159—which created the offices held by the respondents. The Board of Tax Appeals, in its opinion, quoted verbatim from this statute (R. 18-21), supplying italics to emphasize its own point of view.

The cases were heard upon agreed facts which included by reference those facts, alleged in the petitions, which the Commissioner's answers had admitted (R. 35, 36, 53-6). It is not controverted that each petitioner was duly appointed, duly qualified, acted, and received the statutory compensation. The case turns rather upon the character of the office and of the duties which pertained to it; and the single ultimate issue is whether the Federal Government may constitutionally levy an income tax upon that compensation.

There are set out as *Appendix A* (page 42 *infra*) excerpts from the petitions filed with the Board of Tax Appeals, and from the stipulations of agreed fact, to illustrate how the issue was framed before the Board. The facts stated in these excerpts from the petitions were, as there appears (page 43 *infra*), admitted in the answers filed by the present petitioner.

It may be of interest, in examining these excerpts, to compare the descriptions of the respondents' functions, to which the petitioner was then willing to agree, with the characterizations which are put forward in his present brief.

Another circumstance, to which the petitioner now seems not to refer, is that it was expressly agreed as a fact in the Miller cases that the respondent was an officer of the Commonwealth of Massachusetts (R. 53, 56) and that a like agreement was in substance present in the other three cases—"The office . . . was created." (R. 35, 36.)

IV. Relevant Statutes.

No relevant portion of any applicable Revenue Act undertakes to deal with the constitutional principle of exemption which these cases involve. It is conceded that, but for that principle of exemption, the taxes would effectively be imposed by those provisions of the Revenue Acts of 1926 and 1928 to which the petitioner refers.

The Treasury regulation which purports to define and circumscribe the constitutional principle reads as follows:—

> "*Compensation of State Officers and Employees.*
>
> Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States and the commissions of receivers appointed by State Courts, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and

(b) the services are rendered in connection with the exercise of an essential governmental function. But see section 1211 as to 1924 and prior years."

Treasury Regulation 69, Art. 88, and see also *Treasury Regulations* 74 and 77, Art. 643, being, so far as material, substantially the same as above.

The significant provisions of *Massachusetts Special Acts* 1918, *Chapter* 159, are set out as *Appendix B* at page 47 *infra,* with certain portions thereof shown, for emphasis, in italics.

V. Argument.

A. Summary by way of Introduction.

The respondents respectfully contend that the compensation received by them as members of the Board of Trustees of the Boston Elevated Railway Company was not subject to the imposition of a Federal income tax. This contention is not based upon any provision of the Revenue Acts purporting to grant such an exemption, for the relevant Acts are silent with respect thereto. Neither is the contention really rested upon any departmental regulation, for such regulations are hardly competent to increase or diminish the scope of a principle which is exclusively of constitutional derivation. The claim of exemption rests rather upon a constitutional principle, early developed by this Court and ever adhered to, existing for the mutual protection of the states and the nation, and of which the respondents are but the casual and incidental beneficiaries.

There is no intimation that one sovereignty is to be favored over the other; and it follows, therefore, that the ordinary rule of construction, requiring statutory grants of exemption to be strictly construed against the taxpayer, can hardly be apposite. The Board of Tax Appeals seemed to apply such a rule of construction (R. 23); but, of the cases cited by it, one (*Heiner* v. *Colonial Trust Co.*, 275 U. S. 232) related solely to the construction of a statute; another (*Pacific Company, Ltd.* v. *Johnson*, 285 U. S. 480) related to a state constitutional provision with respect to tax-exempt bonds; while the language of the third case but illustrates the nice balance of the constitutional principle, which is to be

> "given such a practical construction as will not unduly impair the taxing power of the one or the appropriate exercise of its functions by the other" (government).
>
> *Susquehanna Power Co.* v. *State Tax Commission*, 283 U. S. 291, 294.

It would seem to follow, also, that the case of *U. S.* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466, referred to by the petitioner, is beside the point for (a) the issue in that case turned upon the provisions of a statute; (b) neither a statute nor a regulation can alter or circumscribe a principle which is solely of constitutional derivation; and (c) the Revenue Acts do not even attempt to deal with the constitutional principle of exemption, with which the present case is concerned, and the re-enactment of a Revenue Act can hardly be given

a greater significance merely because of the Treasury Department having tried in the interim to deal with the subject by regulation.

The respondents as trustees of the Boston Elevated Railway Company were public officers of the Commonwealth of Massachusetts. Moreover, they were the primary executive or administrative officers, whose task was the full and complete administration of the public policy determined upon by the legislature and embodied in *Special Acts,* 1918, *Chapter* 159. As such, they were answerable for their administration of that law to no superior executive or administrative officer except as the Governor, with the advice and consent of the Executive Council, had the power of removal for cause, (pages 47-48 *infra.*)

Primary executive or administrative officers, whether their duties be broad and general or narrow and special ones, are of, and participate in, the very frame-work of government. They are as much a part of the structure of government as the legislature which enacts the law by which their duties are established, or as the Governor who appoints them, or as the Executive Council which approves their appointments. The having of public officers to put into effect the enactments of the legislature is, of its own self, and regardless of the subject matter of those enactments, a central and essential function of government. So only does the state realize itself objectively. So only do the enactments of the legislature become translated into action.

The principle resulting from our dual system of government, that the instrumentalities, means, and operations whereby each government exerts the governmental powers belonging to it are exempt from taxation by the other, has invariably been extended to cases of the compensation of public officers and employees. Distinctions based upon differences in the subject matters of particular governmental activities have been deemed significant only in cases involving excises levied upon business transactions, or involving agencies or instrumentalities remote from the central frame-work of government.

The compensation of the respondents was exempt from tax because they were public officers of Massachusetts, directly entrusted with the administration of a law and were the single means through which the state personified itself for the fulfillment of the policy embodied in that law. Their compensation was exempt irrespective of the subject matter of the law and irrespective of the source of the compensation.

Even if, however, the nature of the respondents' duties were to be viewed as having a bearing upon the question of exemption, we shall contend that the subject matter of transportation is not so obviously and markedly "non-governmental" in character as to require, in the particular case of these respondents and in the light of all their duties, a departure from the hitherto absolute rule exempting the compensation of public officers. We shall further contend that certain fundamental duties of the respondants were, by any standard, governmental.

B. The Respondents were Public Officers of the Commonwealth of Massachusetts.

Material portions of Sections 1 to 15, inclusive, of Special Acts 1918, Ch. 159, are set forth as Appendix B at page 47, *infra*.

This act has been elaborately discussed in opinions and decisions of the Supreme Judicial Court of Massachusetts and of this Court.

Opinion of the Justices, 231 Mass. 603.
Boston v. *Treasurer & Receiver General*, 237 Mass. 403.
Chelsea v. *Treasurer & Receiver General*, 237 Mass. 422.
Opinion of the Justices, 261 Mass. 523.
Opinion of the Justices, 261 Mass. 556.
Boston v. *Jackson*, 260 U. S. 309.

Excerpts comprising the principal judicial discussions of the act are quoted at length in Appendix C at page 57, *infra*.

This statute may be summarized as follows:—

Its underlying policy (as exhibited in section 6) was to provide for the rendering of service by the Boston Elevated Street Railway under such a flexible system of rate-making as would allow the fixing of fares equal, as nearly as might be, to the cost of service; and to secure that the administration of this policy should be in the public behalf and interest. To that end it provided:—

(1) The creation of a board of public trustees to take over, in the Commonwealth's behalf, manage, and operate the Boston Elevated Street Railway under such

a mandate with respect to the equivalence of fares to the cost of service.

(2) The powers and duties committed to the board of trustees to enable them to accomplish the purposes of the legislation.

(3) The terms of the arrangement between the Commonwealth and the stockholders whereby the Commonwealth acquired the right to exercise this extraordinary degree of control over this public utility.

Various special features of the law will be referred to throughout the brief. At this point, we venture to repeat the proposition, which pervades the entire discussion,—*that the board of public trustees are the only state officers to whom the general administration of this act is committed; that all power under the act derives through them; and that they are thus, while acting within the scope of their commissions, the very eyes and hands and mind of the Commonwealth, the immediate instrumentality of its action in the premises, without which the enactment of the legislative policy would be but an idle gesture.*

It has so far appeared firmly established that the respondents were public officers of the Commonwealth. It was so decided in favor of three of the present respondents in *Winthrop Coffin*, 12 B.T.A. 702; it was so agreed between the parties in the present case (see page 3 *supra*); and it was so affirmed by the Board of Tax Appeals even in its present decision (R. 21-22).

The petitioner does not venture to make any direct attack upon this proposition, but contents himself with

saying that "Although the Trustees were appointed under and their tenure and compensation were fixed by the act, and they have been referred to as public officers, it is plain that they were not public officers in the sense of performing governmental duties;" and with frequently referring to the respondents as "agents" or "agencies" (See pages 10, 17, 20, 21, 27 of petitioner's brief). A brief consideration of the characteristics of the position of the Trustees will, we submit, overcome these "arguments by indirection."

The Trustees are appointed by the Governor, with the advice and consent of the Council; are sworn before entering upon the performance of their duties; have a fixed term of office; have a compensation fixed by law; and would be disqualified by personal interest in the Railway Company, just as in General Laws, Ch. 25, Section 3, Commissioners in the Department of Public Utilities are prohibited from having any interest in the companies which come under their jurisdiction. (Section 1 of Special Acts 1918, Ch. 159, at page 47, *infra.*)

They are to have possession of the properties *"in behalf of the Commonwealth* during the period of *public operation";* and their powers are not subject "to the approval, control or direction of any *other* state board or commission." (Section 2 at pages 48-49 *infra.*)

Their duties are defined at great length by law.

These are not all the characteristics, but they are among the dominant ones, and the Board of Tax Appeals in the earlier case correctly stated that:

"They certainly satisfy every requirement of the definition of 'officers' as stated by the Supreme Court of the United States."

Winthrop Coffin, supra, page 706.

"An office is a public station conferred by the appointment of government. The term embraces the idea of tenure, duration, emolument and duties fixed by law. Where an office is created, the law usually fixes its incidents, including its term, its duties and its compensation."

Metcalf & Eddy v. *Mitchell,* 269 U. S. 514, 520.

Of course it was desirable to preserve the ability of private persons to sue the company, rather than the Commonwealth, for wrongs committed in the course of operating the railway, and it was accordingly provided that the Trustees in this regard should *"be deemed* to be acting as agents of the company and not of the Commonwealth," a provision upon which the petitioner now relies (pages 10-11, 13, 16, of petitioner's brief). But the special purposes of this and of certain other like provisions have been fully understood, and the effect properly limited, by the Supreme Judicial Court of Massachusetts in discussing a proposed bill which in this and other relevant respects was identical with St. 1918, Ch. 159.

"The operation and management of the Boston Elevated Railway Company during the term of the lease are to be by a board of public officers for the promotion of the general welfare, although at the same time provision is made for the conserva-

tion of the private interests of the owners of the railway company. . . .

"Under said c. 159, as amended by the proposed bill, the Boston Elevated Railway Company, although privately owned, will not be privately managed. On the contrary, it is to be managed, controlled and operated wholly by the board of trustees who are appointed by the Governor, who constitute a public board, who are for all essential purposes public officers although under said c. 159, Sec. 2, '*deemed to be* acting as agents of the company and not of the Commonwealth,' and whose duties are prescribed by a public statute enacted by the General Court pursuant to its constitutional prerogatives.

"The provision of Sec. 1 of the proposed act, to the effect that the trustees *shall not be considered* public officers within the meaning of G.L. c. 271, Sec. 40, does not impair or affect the general nature of their duties as public officers. The further provision exempting the trustees from the terms of G.L. c. 12, Sec. 3, has no bearing upon the character of their service as public officers. For all other purposes they are public officers. They perform public functions."

Opinion of the Justices, 261 Mass. 523, 542-3.
(Italics ours.)

The contrary expression found in *Boston Elevated Railway Company* v. *Malley,* 288 Fed. 864, 870, ought not, we submit, be given too much weight. It follows directly the quotation from *Boston* v. *Treasurer & Receiver General* to the effect that the trustees were public officers; it fails to give appropriate weight to the judicial construction of a state statute by the highest court of the state; it seems hardly necessary to the deci-

sion; and it was not repeated in the later case of *Boston Elevated Railway Company* v. *Malley*, 24 Fed. (2d) 758, written by the same judge who wrote the opinion of the Circuit Court of Appeals in the present case.

It is respectfully submitted that the respondents were public officers in every sense, and that the petitioner can hardly establish that their compensation is taxable merely by the use of characterizations calculated to derogate from, but without directly attacking, that status.

C. The Compensation of the Respondents, being the means by which their Services as Public Officers were procurred, was not subject to Tax.

In 1842, it was decided by this Court that the State of Pennsylvania might not levy a tax upon the emoluments of the office of captain in the United States revenue cutter service. The decision was placed upon grounds stated by the Court (at page 449) to be "applicable to exempt the salaries of all officers of the United States from taxation by the States."

Dobbins v. *Erie County*, 16 Pet. 435.

Twenty eight years later, in 1870, it was decided that the United States might not tax the compensation of a state Judge of Probate; upon grounds which conferred upon the compensation of all public officers of a state an exemption from taxation by the United States commensurate with that which had been affirmed in the Dobbins case.

Buffington v. *Day*, 11 Wall. 113.

The petitioner (at page 29 of his brief) undertakes to emphasize the *judicial* character of the office involved in the latter case; but it is to be noted that the Court, at the close of its opinion, quoted with approval its former assertion that

> "the reserved rights of the States, such as the right to pass laws; *to give effect to laws through executive action;* to administer justice through the courts, *and* to employ all necessary agencies for legitimate purposes of State Government, are not proper subjects of the taxing power of Congress." (Italics supplied.)
>
> *Veazie Bank* v. *Fenno,* 8 Wall., 533.

There has since stood, for over sixty years, unchallenged in this court so far as we know, the absolute principle that neither sovereignty could tax the compensation of a public officer of the other—"the means by which his services are procured." *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 577.

> See *United States* v. *Baltimore & Ohio R.R.,* 17 Wall. 322, 327. "The right of the States to administer their own affairs through their legislature, executive and judicial departments."
>
> *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 157-8.
>
> *Willcuts* v. *Bunn,* 282 U. S. 216, 225-6.
>
> *Indian Motocycle Co.* v. *United States,* 283
>
> *Indian Motorcycle Co.* v. *United States,* 283 U. S. 570, 577.

The decision in *Metcalf* v. *Mitchell, supra,* contains the following language (Italics are supplied and we have omitted citations):

"Just what instrumentalities of either a state or the Federal government are exempt from taxation by the other cannot be stated in terms of universal application. But this court had repeatedly held that those agencies through which either government immediately and directly exercises its sovereign powers are immune from the taxing power of the other. Thus, the *employment of officers who are to administer its laws,* its obligations sold to raise public funds, its investments of public funds in the securities of private corporations, for public purposes, surety bonds exacted by it in the exercise of its police power, are all *so intimately connected with the necessary function of government, as to fall within the established exemption;* and when the instrumentality is of that character, the immunity extends not only to the instrumentality itself but to income derived from it and forbids an occupation tax imposed on its use.

"When, however, the question is approached *from the other end of the scale,* it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxation on the theory that either he or his property is an instrumentality of government within the meaning of the rule.

"As cases arise *lying between the two extremes,* it becomes necessary to draw the line which separates those activities having some relation to government, which are nevertheless subject to taxation, from those which are immune. Experience has shown that there is no formula by which that line may be plotted with precision in advance. But recourse may be had to the reason upon which the rule rests, and which must be the guiding principle to control its operation. . . .

"While it is evident that in one aspect the ex-

tent of the exemption must finally depend upon the effect of the tax upon the functions of the government alleged to be affected by it, still the nature of the governmental agencies or the mode of their constitution may not be disregarded in passing on the question of tax exemption; for it is obvious that an agency may be of such a character or so intimately connected with the exercise of a power or the performance of a duty by the one government, that any taxation of it by the other would be such a direct interference with the functions of government itself as to be plainly beyond the taxing power.

"*It is on this principle that, as we have seen, any taxation by one government of the salary of an officer of the other,* or the public securities of the other, or an agency created and controlled by the other, exclusively to enable it to perform a governmental function (*Gillespie* v. *Oklahoma, supra*), *is prohibited.* But here the tax is imposed on the income of one who is neither an officer nor an employee of government and whose only relation to it is that of contract, under which there is an obligation to furnish service; for practical purposes not unlike a contract to sell and deliver a commodity. In such a situation it cannot be said that the tax is imposed upon an agency of government in any technical sense, and the tax itself cannot be deemed to be a interference with government, or an impairment of the efficiency of its agencies in any substantial way. . . .

"We do not suggest that there may not be interferences with such a contract relationship by means other than taxation which are prohibited. *Union P. R. Co.* v. *Peniston, supra,* at p. 36 (21 L. ed. 793), recognizes that there may. Nor are we to be understood as laying down any rule that taxation might not affect agencies of this character

in such a manner as directly to interfere with the functions of government and thus be held to be void.

"But *we do decide that one who is not an officer or employee of a state,* does not establish exemption from Federal income tax merely by showing that his income was received as compensation for service rendered under a contract with the state; *and when we take the next step* necessary to a complete disposition of the question, *and inquire into the effect of the particular tax on the functioning of the state government,* we do not find that it impairs in any substantial manner the ability of plaintiffs in error to discharge their obligations to the state, or the ability of a state or its subdivisions to procure the services of private individuals to aid them in their undertakings."

We have searched diligently and, we hope, thoroughly, to see whether the absolutism of the above language with respect to the exemption of the compensation of a state officer has been modified, and to see whether any further test of "essential governmental" quality has been applied in addition to the ascertainment of the existence of a public office, directly charged with the administration of a law; and we have found no decision which seemed to go to that extent.

The petitioner (at page 28 of his brief) seems to believe that the words, "The salary of an officer," in the foregoing quotation (page 16 *supra*) are modified by the words "exclusively to enable it to perform a governmental function." It is submitted that a reading of the entire passage does not lead to this result.

The rule of *Metcalf* v. *Mitchell* is thus restated by Chief Justice Hughes:

> *"Thus, while the salary of an officer of the state cannot be taxed by the Federal government,* the compensation paid by a state or a municipality to a consulting engineer, who is neither an officer nor an employee of government, for work on public projects, may be subjected to a Federal income tax. *Metcalf* v. *Mitchell,* 269 U. S. 514, 524, 70 L. ed. 384, 392, 46 S. Ct. 172."
>
> *Willcuts* v. *Bunn,* 282 U. S. 216, 225-6.

The proposition remains unqualified in the language of another subsequent decision:

> "It has been further adjudged that the salary of an officer of the United States is immune from state taxation because the salary is the 'means by which his services are procured and retained' and its taxation by a state would burden the exertion by the United States of powers belonging to the latter. *Dobbins* v. *Erie County,* 16 Pet. 435, 448, 449, 10 L. ed. 1022, 1027. And 'for like reasons' it has been held that the salary of a state officer is immune from Federal taxation. *Collector* v. *Day* (*Buffington* v. *Day*), 11 Wall. 113, 124, 20 L. ed. 122, 125."
>
> *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 577.

It is therefore submitted that when it appears that the respondents are members of a state board; appointed by the same authority by which the highest executive and judicial officers are appointed; installed in office upon oath; with long and certain tenure; with emolument fixed by law; entrusted with the administration of an important piece of legislation; and, what is more, with the primary responsibility to develop

administratively the details of the legislative policy embodied in that law; and subject to the mandates of no superior; it thence also appears that they are state instrumentalities of government whose compensation the Federal government may not tax.

We do not believe that it will be helpful to list here, and distinguish, one by one, the various cases which in recent years have dealt with compensation for services more remotely connected with the administration of government. They are all cases which arise in the "no-man's-land" indicated by *Metcalf* v. *Mitchell*—*"lying between the two extremes"*; while the case of the compensation of a public officer still stands *at one extreme,* among those cases which fall with certainty within the exemption. (See language quoted at page 15 *supra.*)

Concededly, the asserted principle of the exemption of the compensation of public officers is but a branch of a broader principle of non-interference; and the boundaries of the broader rule are set by the reasons for its existence.

See *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575-6.

But we submit that the reason of the broader rule calls for the absolute principle of exemption for which we contend. Each government is entitled to exercise all its lawful powers, and to that end must have executive and administrative officers, for few, if any, laws or policies are self-effectuating merely upon the declar-

ation of the legislature. It is one thing to say that a business upon which a state embarks must remain taxable *as a business* and quite another thing to say that the power of the state to have primary executive or administrative officers—no matter for what public purpose so long as it be lawful—is subject to taxation, and hence to destruction, at the choice of the Federal government.

The three decisions upon which the petitioner places his greatest, if not really his sole, reliance are wholly distinguishable upon this ground.

Flint v. *Stone Tracy Co.*, 220 U. S. 107, related to the excise known as the "corporation tax" and the actual question involved was whether a street railway company, simply because it operated under a state charter, was exempt from the tax. No element of public ownership or operation was involved. The Court made use of the expression "essential governmental function," and said, at page 172,—

> "The true distinction is between the attempted taxation of those operations of the state essential to the execution of its governmental functions, *and which the state can only do itself*, and those activities which are of a private character. The former, the United States may not interfere with by taxing the agencies of the state in carrying out its purposes; the latter, although regulated by the state, and exercising delegated authority, such as the right of eminent domain, are not removed from the field of legitimate Federal taxation."

This case, however, contains no intimation that in the case of the compensation of a public officer, charged

directly with the administrative enforcement of a state law, there is to be applied some further test as to whether such officer is engaged in the performance of "essential governmental functions." On the contrary, the very case contains the following unqualified language:

> "The exercise of such rights as . . . the employment of officers to administer and execute the laws, and similar governmental functions, cannot be taxed by the Federal government."
>
> *Flint* v. *Stone Tracy Co., supra,* 158.

South Carolina v. *United States,* 199 U. S. 437, related to a license tax, imposed upon dealers in intoxicating liquors, and held applicable to the individual dispensers of liquors at certain state dispensaries, who were reached by the federal statute "because they were the actual sellers." No question was involved as to a tax upon the compensation of public officers charged with administering the policy of a state law—not even of a law relative to government sale of liquors. The tax was on the business, and the business, it was held, was of a private nature.

Ohio v. *Helvering,* 292 U. S. 360, presented the modern example of the situation which had existed in the South Carolina case, and it was made perfectly clear by the Court that the Federal excise was capable of reaching not merely the "actual sellers" but also the state itself, when it embarked upon the traffic in liquor which the Court held to be a business of a private nature.

We neither do, nor have need to, offer any criticism, express or implied, of these decisions. We are not contending that the street railway business was not subject to excise taxes, or that the salaries of those in the employ of the railway company were not subject to income tax. We are contending that the compensation of the primary public officers, *who were not in the employ of the corporation but who rather were, in the state's behalf, in possession of the corporation* (see section 2 at page 48 *infra*), was not taxable. And this contention is being advanced, not primarily on the ground that it is an "essential governmental function" to run a street railway, but because it is of the very essence of government to have executive and administrative officers as a means to enable the state to exercise its lawful powers at all.

We are unable to see that the present case is any more governed by anything that was said in *Ohio* v. *Helvering* than by the actual decision in that case. Of the various cases cited for the proposition that

> "when a state enters the market place seeking customers, it divests itself of its *quasi* sovereignty *pro tanto* and takes on the character of a trader so far at least as the taxing power of the Federal government is concerned,"

the case of *Georgia* v. *Chattanooga,* 264 U. S. 472, dealt with the power of the state to take by eminent domain land within its borders owned by another state and used for a railroad by that state; while the remaining cases —*Bank of United States* v. *Planters Bank,* 9 Wheat.

904; *Bank of Kentucky* v. *Wister,* 2 Pet. 318; *Briscoe* v. *Bank of Kentucky,* 11 Pet. 257; *Curran* v. *Arkansas,* 15 How. 304,—dealt with the status of certain private corporations and with the significance of their private transactions.

To this latter list might be added the case of *State of North Dakota* v. *Olson,* 33 Fed. 2d, 848, dismissed for want of jurisdiction, 280 U. S. 528; to which the petitioner refers. In each case the status of the corporation, or the significance of its transactions, or its liability to tax, was held not to have been changed by virtue of the state's participation in the enterprise through the ownership of its capital stock. No one of these cases involved directly, or indirectly, or even remotely, the taxability of the compensation of a primary administrative or executive officer of a state.

It is submitted that while the expression, "essential governmental function" has received the approval of this Court, it notwithstanding does not constitute, by itself alone, the safe starting point of a strictly deductive reasoning. It seems rather a convenient, general phrase to express in summary form certain, but not all, of the lines of distinction marked out by the cases which have expounded the constitutional principle.

Thus, for example, in *United States* v. *Baltimore & Ohio Railroad Co.,* 17 Wall, 322, it was held that the Federal government could not levy a tax upon the income received by the City of Baltimore from bonds of the Baltimore & Ohio Railroad, notwithstanding that the investment had been made and held for the primary

purpose of conferring upon the inhabitants of the city a greater prosperity through the development of the railroad. This case has stood unquestioned for over sixty years, notwithstanding that the one dissenting Justice endeavored to make with respect to municipally owned property precisely the same distinction as that which the petitioner now advances in a different connection. It illustrates the care with which the expression "essential governmental function" needs to be used. It may not have been an "essential government function" of the State of Maryland to lend money to railroads for the purpose of encouraging their development. But it was an "essential governmental function" of the state, and so of its municipal corporation, to hold its own property and to receive the income therefrom.

In the present case, the operation of a street railroad may not be an "essential governmental function." When, however, the state, within its lawful powers, has determined upon a public policy and has legislated with respect, thereto, it is of the essence of government to have some primary executive or administrative officers whereby to make that policy manifest in action. And this remains true even though the subject matter of the policy is the control or even operation of a public utility.

D. It is Immaterial that the Respondents' Salaries were paid "by the Company."

We respectfully submit that it does not matter by whom the respondents' salaries were paid so long as

they were paid in accordance with the provision made therefore in the statute creating the office. This follows from the nature of the constitutional principle itself. The compensation of a public officer is the "means by which his services are procured."

Indian Motocycle Company v *United States*, 283 U. S. 570, 577.

If the state can successfully provide that the compensation be paid out of other than public funds, the burden of the compensation is thereby held off from the public funds; but if such means fail, then the state must in the end provide for a compensation of which it bears the direct burden. In either case, the compensation remains the means by which the services are procured.

If, therefore, the Federal taxing power cannot reach a state public office, then it cannot reach the statutory compensation annexed to that office, whether the compensation be payable by the state or by someone else.

The petitioner says (brief, page 22) that "The burden of the tax here in question falls solely upon the respondents individually." In the only sense in which this expression is true, it would be equally true with respect to an income tax upon the salary of the Governor.

We know of no case where the distinction for which the petitioner contends has appeared, except, possibly, *Miller* v. *McCaughn*, 27 Fed. (2d) 128, which related to the compensation of an auditor appointed by the

Orphans Court in Philadelphia to ascertain and report upon the financial worth of companies applying to the court for leave to furnish surety bonds. There was no such office created by law, the appointment was purely a matter of convenience and the compensation was paid from a fund contributed by applying surety companies. Such a case seems wholly distinguishable.

On the other hand, the Treasury Department itself has long recognized that, in the case of a public officer, the source of the emolument fixed by law was not material. See, for example:

5 C. B. 106. (Fees of deputy sheriffs.)
II-1 C. B. 71. (Compensation of state employees under Sheppard-Towner Act.)
II-1 C. B. 72. (Fees of public administrators paid out of the estates.)
IV-2 C. B. 46. (Receivers of insolvent state banks paid out of bank assets.)

Once it is established that the constitutional principle applies,

> "It is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute."
>
> *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575.

It is submitted that the petitioner's contentions (brief, pages 9-10, 32) with respect to the "allocation" of compensation are wholly incompatible with this principle.

The provision for the payment of the respondents' salaries "by the Company" was probably inspired by

precedent. There had been a time when the salaries and expenses of the Railroad Commissioners of Massachusetts had been raised by assessment upon the regulated companies (See R. L. chap. 111, sec. 10; Acts 1906, chap. 463, sec. 3; Acts 1909, chap. 490, Part III, sec. 9). This had also been true with respect to the Gas and Electric Light Commissioners (R. L. chap. 121, sec. 4; Acts 1909, chap. 490, Part III, sec. 9). Even today one-half of the salaries of the Commissioners in the Department of Public Utilities, together with that portion of the expenses of the Department incurred in connection with the regulation of gas, electric and water companies, are raised by assessment upon the regulated utilities.

In the present case, however, the payment "by the Company" seems more a matter of form than of substance. Under Section 13 of the act, page 54 *infra,* it was provided that, at the expiration of the period of public control, any deficiency arising from operating deficits should be made up by the Commonwealth and, on the other hand, that any surplus resulting from operations should belong to the Commonwealth. Thus, the entire period of operation is at the financial risk of the Commonwealth, and the gains, if any, belong to it. Any factor entering into the costs of the period of public control was bound to affect the net outcome to the Commonwealth. The respondents' salaries were such a factor.

That operating deficits in fact occurred and were made up by public taxation (R. 21) gives added em-

phasis, but the result should be no different even if no deficits had occurred. The salaries, by whomsoever paid, were the statutory compensation annexed to the office.

E. The Respondents were no less Instrumentalities of Government by reason of their being concerned with Transportation.

In this connection we assume that the principal reliance of the petitioner is placed upon *Flint* v. *Stone Tracy Co.*, and particularly upon the following language (italics supplied):

> "It is *no part of the essential governmental functions of a state to provide means of transportation,* supply artificial light, water, and the like. These objects are often accomplished through the medium of private corporations, and though the public may derive a benefit from such operations, the companies carrying on such enterprises are nevertheless private companies, whose business is prosecuted for private emolument and advantage. For the purpose of taxation they stand upon the same footing as other private corporations upon which special franchises have been conferred."
>
> *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 172.

To this language, when confined to the actual decision—namely, that an ordinary public utility company was not exempt from the Federal Corporation Tax—there may doubtless be no occasion to take exception. But when it is stripped from its context and used as the basis of a wholly different contention, it does not seem so secure from criticism.

To illustrate: let the assertion that "it is no part of the essential governmental functions of a state to provide means of transportation" be considered. Now one fair test of what is "essential" in government might be to inquire what governments have always done. And governments have always concerned themselves to some extent (and not merely by regulation) with providing and promoting means of transportation. The Roman roads; the inclusion in the Stat. 43 Eliz. c. 4 of "repairs of bridges, ports, havens, causeways . . . and highways"; modern road and bridge building; the Panama Canal; may perhaps come to mind.

True, transportation has changed greatly and offers problems much more complex than it once did, but it might be difficult to weigh accurately the importance of one factor of transportation in one age to one government as against that of a different one in a different age to another.

The Federal postal service would hardly be thought proprietary as distinct from governmental, but it is nothing but a specialized system of transportation which now competes with private carriers in certain respects; and the power to establish post offices is linked with the power to establish post *roads*. Constitution, Art. I, Section 8. It might be thought strange that in a government of delegated powers, the power to operate this particular transportation service is "essential," while in a government of reserved powers, the whole subject matter of means of transportation is claimed to be "non-essential."

Or take this expression from the *Flint* case: "The true distinction is between . . . those operations of the state essential to the execution of its governmental functions, *and which the state can only do itself*, and those activities which are of a private character." As a matter of pure logic, these words might warrant the conclusion that the making of war is not an essential governmental function because of historical precedent for the use of mercenaries who were hardly more than independent contractors; or the conclusion that the bureau of internal revenue is not "essential" because in certain times and places the institution of "farmers of the revenue" worked very nicely.

It may, therefore, not be surprising that, on the question whether providing means of transportation is a genuine and long established subject matter of government, the weight of the later cases, despite the dictum in *Flint* v. *Stone Tracy Co.*, seems to be in the affirmative. The cases to which we refer are collected and abstracted in *Appendix D*, at page 63 *infra*.

On the other hand, there is undoubted force to the argument that indefinite expansion of the functions of one government cannot be allowed to withdraw all activities within its borders from the taxing power of the other.

Cf. *South Carolina* v. *United States*, 199 U. S. 437, 454.

But we are not discussing the taxability of the railroad property, or of the railroad income, or of the compensation of employees of the railroad company. We are,

at this point, merely asserting that there is nothing so violently non-governmental about the subject matter of providing means of transportation as to require the modification of the absolute rule with respect to the exemption of public officers' compensation, as repeatedly stated by this Court.

In passing, there is one sense in which the words of the *Flint* case are presently apposite. One thing which "the state can only do itself," within the fair meaning of these words, is to have its own superior administrative officers through whom to act and thus effectuate in detail the policies formulated by its legislature. And the respondents were such an instrumentality.

F. From other Aspects the office of the Respondents was close to the Core of Government.

The constitutional principle upon which the respondents rely is a principle involving the exercise of fair judgment in practical affairs to the end that the unqualified powers granted by the Constitution to the Federal Government shall not be utilized to destroy or impair the equally unqualified powers reserved by the Constitution to the several states, and vice versa. This end is to be accomplished without unreasonably narrowing the scope of the taxing power of either sovereignty. The closer, therefore, the function sought to be taxed comes to the core of government, the more imperative it is that the taxing power be restrained.

This question of degree is illustrated in the decisions of this Court, but we have found no intimation therein

that there is a further question of degree *within* the class of public officers entrusted with the primary administration of laws.

If, however, it were to be assumed that there is such a further question of degree, it is submitted that the respondents are not thereby remitted to that outer circle of functions remotely connected with government, taxation of which is permissible.

This unique legislation has few parallels that we know of and it is more nearly similar to the Federal control of railroads and telephone and telegraph companies, in war time, than to any other situation upon which the courts have had occasion to pass.

See *Biscoe* v. *Tax Commissioner,* 236 Mass. 201.

The act was passed in time of war to protect the public interests against the threatened breakdown of the principal local transportation system of a large city which was both the state capital and an important and active industrial center, including many industries engaged in war work. The road had already been under public regulation of the ordinary sort, but the state of its finances imperiled its continued operation and it was not believed that such adjustments as could be made slowly under ordinary regulation would relieve the situation.

The law discloses, upon its face, that the fundamental policy determined upon was that the road should be operated at rates equivalent to cost of service. (See Secs. 6 and 7 at pages 51-52 *infra.*)

To effectuate that policy, it was felt necessary that for ordinary regulation on the part of the Commonwealth there should be substituted public management to the end that the cost of service and hence the fares should remain truly under public control. Thus it was necessary to make a trade with the owners of the road whereby, for a fixed compensation, they permitted the Commonwealth to add powers of management to those powers which the state already had by way of regulation.

There was therefore made what was in substance a lease by the Commonwealth of the railway company and its physical properties, and the company was to be run by the Commonwealth through its public officers and, in the last analysis, at the financial risk of the Commonwealth, with the burden eventually being borne by the municipalities which the railway served.

Practically all the machinery for operation was already available in the corporation and its existing staff, but it was necessary to have some public officer or officers, who should be the administrative arm of the government in the actual effectuating of the legislative policy, and in whom should be vested all ultimate administrative powers under the act. Had the legislature chosen to turn this task over to some already existing board of public officers, such as the public service commissioners or the highway commissioners, we would imagine that the present question never would have been raised by the Treasury Department. It was, however, thought best to create a new state board for the special purpose.

The new board thus created was given all the powers to effectuate all the purposes of the law, including the powers to do, with respect to this particular transportation system, all those things of a regulatory nature theretofore entrusted to the department of public utilities, and the further power to fix and determine the incidence of taxation to raise the revenues necessary to take care of any operating deficits.

By way of illustration, merely to call to mind the type of subject matter ordinarily controlled by the public service commissioners (or now by the commissioners of public utilities) but under this law administered by the board of trustees, we would mention a few of the things which the trustees were to do in the ordinary course of their duties. They fixed fares; determined questions with respect to transfers; determined the character and extent of the service and facilities to be furnished; and, within the latter category, dealt with the questions of the kind of vehicles to be operated on given lines, frequency of operation, location of stopping places, giving of new service and abandonment of old services once undertaken, building of extensions and removal of trolley tracks, poles and wires once already located, adequacy of shelters and transfer stations, speed, emergency stops, safety equipment, rules of conduct and the like.

It is thus not surprising that in the present case the government has admitted that

> "The jurisdiction of the Public Service Commission of the Commonwealth with respect to fares

> . . . and facilities and services of the Boston Elevated Railway was terminated and transferred to said Board of Trustees." (Record, page 4.)

Or that

> "Said Board of Trustees became at all times after July 1, 1918 a special Public Service Commission in respect to the Boston Elevated Railway Company." (Record, page 40.)

The general functions of public service commissions are too well known to require discussion, and, as said in *Burnet* v. *Livezey,* 48 F. (2d) 159 at 161,

> "There can be no doubt but that the commission was itself an agency of the state, performing governmental functions."

At this point we may be met with *Ohio* v. *Helvering,* and with the unquestionable doctrine that "the police power . . . applied to business activities is the power to regulate those activities, not to engage in carrying them on,"

Ohio v. *Helvering,* 292 U. S. 360,

from which it may well follow that the power which the Commonwealth of Massachusetts exerted through the respondents was not the "police power."

But we are not contending that, because a state may regulate a business under the police power, the embarking upon the business, even by the state, is an exercise of the police power. Nor that the business, when embarked upon by the state, loses *as a business* its private character or ceases to be a legitimate object of Federal Taxation. What we do seek to point out is that

(a) The public interest served by public management may be identical with that which sustains the police power.

(b) The ultimate object of assuming management may be—and in this case was——to effectuate fully one of the public purposes to subserve which the police power exists.

(c) When a public officer actually does the things which are of the essence of the regulatory power, their character is not changed by the fact that he does other and further things which are non-regulatory in character.

(d) When the assumption of management grows out of the exigencies of regulation, it cannot withdraw from the taxing power of the Federal government that which even under regulation was subject thereto; but it does not follow that the effect is to subject to the Federal taxing power that which theretofore was not subject thereto.

Lastly, in this discussion of the nature of the things which the respondents did, it is to be recalled that *among their basic powers was the power to determine the amount necessary to be raised by taxation to make up any operating deficits, and apportion the burden of taxation among the municipalities which the railway served.*

Now it hardly seems possible that the Commonwealth, in respect of its power to apportion the public burden of taxation, can lose its sovereign character. As to the exercise of this power in this instance, the Supreme Judicial Court has said as follows:

"The assessment authorized by Sec. 14 is an apportionment of one of the burdens of general taxation. It is not the levy of a betterment assessment and has nothing in common with such an assessment. The case at bar, like *Kingman, Petitioner,* 153 Mass. 566, deals 'with a legislative distribution of public burdens among different political subdivisions of the Commonwealth, and the language in it must be construed in reference to the facts to which it relates. The right to apportion public burdens among cities, towns, and counties as it deems reasonable, in reference to benefits and to other considerations which are not capable of exact estimation in money, is within the power of the Legislature under the first part of art. 4, c. 1, Sec. 1, of the Constitution, and is not the same as the right to impose and levy taxes upon individuals. It is of the same nature as the right to create, change, or abolish cities, towns, or other political subdivisions of the Commonwealth." *Sears* v. *Board of Aldermen of Boston,* 173 Mass. 71, 78. . . .

"There is no delegation of legislative power in the authorities vested in the trustees. The general principles to be observed are set forth in the statute. It is the carrying out of those principles with discretion, fidelity and wisdom that is vested in the trustees. However onerous that may be as an administrative burden, it does not partake of the nature of a legislative function. While such details might be included in the statute, no constitutional mandate is violated by leaving them to the decision of the trustees."

Chelsea v. *Treasurer & Receiver General,*
237 Mass. 422, 431.

With respect to this power, the petitioner says (brief, page 30) "The Trustees had no power to levy taxes. They could only certify the amount of any deficit to

the Treasurer or Receiver General, a mere ministerial act." This statement wholly overlooks the duty of the Trustees with respect to apportioning the burden of the tax. See Section 14 at page 55 *infra.*

In was this duty of which the Supreme Judicial Court was speaking, in the words quoted above—"However onerous that may be as an administrative burden—," and there seems to be something almost studied in the characterizations by which the petitioner endeavors to diminish the status of the respondents as public officers, the governmental significance of their duties, and the degree of discretion entrusted to them in administering the public policy embodied in the act. When he refers to them as "ministerial," we cannot but recall that the constitutional principle was first developed in a case involving a captain of a revenue cutter. It can hardly be a valid distinction that he was about the business of collecting Federal taxes rather than of apportioning the burden of state taxes.

What we have said does not seem to us inconsistent with the decisions of the district court in *Boston Elevated Railway Company* v. *Malley,* 288 Fed. 864; *Boston Elevated Railway Company* v. *Malley,* 24 Fed. (2d) 758.

The first of these cases involved the taxability of payments made under a private contract for ordinary services rendered in the course of the ordinary operation of the railway. We have had occasion to comment on some of the language of the decision at page 12, *supra.* The second case was likewise concerned

with the incidence of a tax upon the railway business. The underlying thought of both decisions seemed to be that, the statute having expressly left the business open to all forms of state taxation, it should fairly be deemed open to Federal taxation as well.

We repeat once more that we do not feel forced to contend that the railway business was non-taxable. Our contention is that the board of trustees, as the public officers through whom, under the legislature, the Commonwealth directly manifested itself in action, were a non-taxable instrumentality, so far as concerned a direct tax levied upon their compensation.

G. Summary in Conclusion.

It is of the very essence of a government to be able to personify itself in public officers, and through its executive or administrative officers to manifest in action the policies, within its lawful powers, upon which it has determined through its legislative branch. Hence a public officer, and especially a primary officer, is an essential instrumentality of government, and to have such officers is in itself an essential function of government.

This Court has on frequent occasions discussed with thoroughness the scope of the constitutional principle of exemption and has on no occasion failed to place public officers, as such, among those instrumentalities of government, which are "essential." It has never been intimated that public officers were to be classified according to the nature of the subject matter to which

their duties pertained, as essentially governmental officers, officers not essentially governmental and officers having duties partly governmental and partly not.

The compensation of a public officer is the means of obtaining his services. It has never been suggested that it is any less the means because paid by fees or from some source, other than public funds, which the state was competent to command. Still less has it ever been suggested that it is subject to an artificial "allocation" upon the basis of a classification of duties. It is wholly exempt.

The respondents were public officers and were, moreover, primary officers. The state spoke through the legislature but when it came to act, it acted first through them. Their compensation fell within the constitutional principle, notwithstanding the state procured it to be paid in the first instance out of a private fund, the integrity of which fund, however, the state had agreed to underwrite.

Upon the basis of decisions dealing solely with excise taxes levied upon business activities, and not with direct taxes levied upon public offices or the emoluments thereof, the petitioner seeks to exclude the respondents from the scope of the exemption. It is submitted that the cases are wholly distinguishable. A state cannot raise a private business to its own level; but, at its own level, it is competent to develop a public policy even with respect to its relations to a private business and it has a constitutional right to have public officers through whom to act in respect of a public policy coming within its lawful powers.

Even if the respondents' duties be scrutinized as to their subject matter, there appears no sufficient ground for making of them an exception to the heretofore absolute rule exempting from Federal taxation the compensation of public officers of a state. Governments have concerned themselves for centuries, and not by regulation alone, with the means of transportation. The respondents, while very likely not in the exercise of the "police power," dealt extensively with a common subject matter of public regulation, acted in the identical interest in which public regulation is exerted, and to the same substantial ends. They were, moreover, charged with the apportionment of a heavy burden of state taxation.

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX A.

Excerpts from allegations of petitions, as admitted by Commissioner's answer; and from agreed facts.

The petitions filed with the Board of Tax Appeals contained the following averments:—

In the Powers, Coffin and Harriman petitions it was averred:—

> "5 (b) Pursuant to said Special Act the Trustees took and had possession of the property of the Boston Elevated Railway Company in behalf of the Commonwealth, appointed and removed officers of the corporation, regulated and fixed fares, including the issuing, granting and withdrawal of transfers, determined the character and the extent of the services and facilities to be furnished, issued stock, bonds and other evidences of indebtedness, determined the amount of any deficiency resulting from the operation of the railway and notified the Treasurer and Receiver General of the Commonwealth thereof, whereupon it became the duty of the Commonwealth to pay over to the company the amount so ascertained, and apportioned among the cities and towns in which the railway was operated the taxes to be assessed upon them as an addition to the State tax wherewith to pay such deficiency, all as more fully appears in said Special Act to which reference is hereby made and a copy of which will be adduced in evidence. The jurisdiction of the Public Service Commission of the Commonwealth with respect to the fares, stock and bond issues, and facilities and services of the Boston Elevated Railway was terminated and transferred to said Board of Trustees."

(R. 4 and see also 9 and 12.)

In the Miller petitions it was averred that:

"Under said Act the trustees are also given the right to regulate and fix fares, including the issue, granting and withdrawal of transfers, and the imposition of charges therefor, and to determine the character and extent of the service and facilities to be furnished and 'in these respects their authority shall be exclusive and shall not be subject to the approval, control or direction of any other state board or commission.' Powers were thus given the board of trustees which had been previously vested in and exercised by the public service commission of the Commonwealth of Massachusetts, and by virtue of said Chapter 159 said board of trustees became at all times after July 1, 1918, a special public service commission in respect to the Boston Elevated Railway Company.

"A more extended statement of the separate provisions of said Chapter 159 is here omitted in view of the former decision of this Board in the case Docket No. 17002 between the same parties, but said Chapter 159 which became effective in all its provisions is hereby attached, marked 'Exhibit B,' and made a part hereof."

(R. 40 and see also 47.)

These various averments were admitted by the Commissioner's answers, (R. 8, 11, 16, 44, 49.)

The agreed facts in the Powers, Coffin and Harriman cases contained, among other matters, the following additional material:—

"2. The office of trustee of the Boston Elevated Railway Company was created by Chapter 159 of the Special Acts of 1918 of the Commonwealth of Massachusetts, which Act was passed in May 1918 and went into full force and effect in that year, all prescribed conditions, as to acceptance by stock-

holders and the like, having been fulfilled. Said Act was in force and effect throughout the year 1927. For the general background in fact of this legislation, reference may be made to the various decisions and opinions of the Supreme Judicial Court of Massachusetts and the United States Supreme Court wherein the same is discussed, cited in the decision of the Board in the case of *Winthrop Coffin* v. *Commissioner of Internal Revenue,* 12 B.T.A. 703.

"4. If material, the Commonwealth in the year 1919 became required, under the terms of said Act and especially section 11 thereof, to pay over to the Board of Trustees of the Boston Elevated Railway Company the sum of $3,980,151.67. This amount was determined by the Board of Trustees of the Boston Elevated Railway Company and by them apportioned among the cities and towns in which the railway was operated. No reimbursements were made to the Commonwealth on account of said payment prior to 1922 nor in the year 1924. Operations during the years down to and including 1928 did not result in an excess sufficient to enable the full reimbursement of the $3,980,151.67 to the Commonwealth.

"6. The tax return of the petitioner's decedent for the year in question may be placed in evidence. The said Chapter 159 of the Special Acts of 1918 of the Commonwealth of Massachusetts may be judicially noticed, and as well any other pertinent provision of Massachusetts or United States law."

(R. 35, 36.)

The agreed facts in the Miller cases contained, among other matters, the following:—

"Chapter 159 of the Special Acts of 1918 became duly operative by the performance of all condi-

tions upon the happening of which the Act was to take effect and was in operation during the years of 1926 and 1927. The petitioner, as a member of the board of trustees of said Boston Elevated Railway Company, created by and under said Chapter 159, was engaged during said years 1926 and 1927 in exercising and performing the several powers and duties bestowed upon said board of trustees by said Chapter 159.

"Said Act transferred to the board of trustees powers of management and operation previously vested in the board of directors of the private corporation. The powers thus transferred include the right to make contracts in the name of the corporation; to receive and pay out all income or other moneys to which it is entitled; to issue stock, bonds or promissory notes of the company; and to appoint and remove all officers of the company other than the board of directors.

"Under said Act the trustees are also given the right to regulate and fix fares, including the issue, granting and withdrawal of transfers, and the imposition of charges therefor, and to determine the character and extent of the service and facilities to be furnished and 'in these respects their authority shall be exclusive and shall not be subject to the approval, control or direction of any other State board or commission.' Powers were thus given the board of trustees which had been previously vested in and exercised by the public service commission of the Commonwealth of Massachusetts.

"The Board of Tax Appeals, or any tribunal dealing with the petition in the above entitled case, may take judicial notice of, and there are incorporated herein by reference, said Chapter 159 of the Special Acts of Massachusetts for 1918 and the statements of fact so far as pertinent in the vari-

ous decisions and opinions of the United States Supreme Court, of the Supreme Judicial Court of Massachusetts, and of the Board of Tax Appeals, wherein said Act is discussed, and any other public laws of the United States or the Commonwealth of Massachusetts pertinent hereto; and also any additional matter contained in the taxpayer's petition and admitted by the respondent's answer filed herein."

(R. 54, and see also 56.)

APPENDIX B.

SPECIAL ACTS, 1918.

CHAPTER 159.

[Italics ours.]

THE COMMONWEALTH OF MASSACHUSETTS.

IN THE YEAR ONE THOUSAND NINE HUNDRED AND NINETEEN.

AN ACT.

To provide for the Public Operation of the Boston Elevated Railway Company.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. *The board of trustees* of the Boston Elevated Railway Company is hereby created, to consist of five persons *to be appointed by the governor, with the advice and consent of the council.* The persons so appointed *shall be sworn before entering upon the performance of their duties; shall own no stock or other securities of the Boston Elevated Railway Company* or of any company owned, leased or operated by it; *shall serve for the term of ten years* from the date when they assume the management of the company as hereinafter provided and until their successors are duly appointed and qualified, and each *shall receive from the company as compensation for his services five thousand dollars annually.* In case of any vacancy in said board by reason of death, resignation or otherwise, the governor, by and with the consent of the council, shall fill the vacancy. The board shall designate one of the trustees so appointed to serve as chairman. *Any member of*

the board may be removed for cause by the governor, with the advice and consent of the council.

Said trustees shall not be considered public officers within the meaning of section twenty-five of chapter five hundred and fourteen of the acts of nineteen hundred and nine, but shall be subject in all other respects to the provisions of said section to the same extent as are the directors of the Boston Elevated Railway Company, but said section shall not apply to recommendations by the governor to said trustees. The provisions of section one of chapter seven of the Revised Laws shall not apply to the said board.

If the public management and operation of the railway system of the Boston Elevated Railway Company shall continue beyond the original period of ten years the governor shall, with the advice and consent of the council, at the expiration of each ten-year period during the continuance of public management and operation, appoint five successor trustees to serve for a period of ten years, and until their successors are appointed and qualified, but not exceeding the period of public management and operation. Said trustees shall assume the management and operation of the company's property on the first day of the month next following their appointment and qualification.

SECTION 2. Said board of trustees, hereinafter called the trustees, *shall manage and operate the Boston Elevated Railway Company* hereinafter called the company, and the properties owned, leased or operated by it, for a period of ten years, commencing on the first day of the month next after their appointment and qualification, and subject to the provisions of this act, *shall take and have possession of said properties in behalf of the commonwealth during the period of public operation,* and, for the purposes of this act, shall, except as is otherwise provided in this act have and may exercise all the rights and powers of said company and its directors, and, upon behalf of said com-

pany, shall receive and disburse its income and funds. They shall have the right to appoint and remove in their discretion the president, treasurer and clerk of the corporation, and all officers of the company other than the board of directors. They *shall have the right to regulate and fix fares,* including the issue, granting and withdrawal of transfers, and the imposition of charges therefor, and *shall determine the character and extent of the service and facilities to be furnished, and in these respects their authority shall be exclusive and shall not be subject to the approval, control or direction of any other state board or commission.*

In the management and operation of the said company and of the properties owned, leased or operated by it, as authorized by this act, the trustees and their agents, servants and employees shall be deemed to be acting as agents of the company and not of the commonwealth, and the company shall be liable for their acts and negligence in such management and operation to the same extent as if they were in the immediate employ of the company, but said trustees shall not be personally liable. A majority of the board shall constitute a quorum for the transaction of business, and the action of a majority of those present at any meeting shall be deemed the action of the trustees.

Nothing herein contained shall be held to affect the right of the commonwealth or any subdivision thereof to tax the company or its stockholders in the same manner and to the same extent as if the company had continued to manage and operate its own property.

SECTION 3. The trustees shall have authority to make contracts in the name and on behalf of, and to issue stocks, bonds and other evidences of indebtedness of, the company. The trustees shall cause to be paid all amounts which may from time to time become due from the company, and shall declare dividends at the appointed times upon the preferred and common stock of the company, and provide for the payment of the same.

SECTION 4. The stockholders of the company shall, as heretofore, elect a board of directors which shall, however, during the period of public operation, have no control over the management and operation of the street railway system, but its duties shall be confined to maintaining the corporate organization, protecting the interests of the corporation so far as necessary, and taking such action from time to time as may be deemed expedient in cases, if any, where the trustees cannot act in its place. The by-laws of the company shall be modified, as far as may be necessary, to conform to the provisions of this act.

By its acceptance of this act, the company and the stockholders and directors thereof shall be deemed to have assented to and authorized all issues of stock, bonds and other evidences of indebtedness which the trustees may find necessary or advisable during the period of public operation, or which may be required during the period of public operation to carry out any existing or future obligations of the company; but, notwithstanding such assent and authorization, the stockholders and directors shall from time to time take such action with respect thereto as may be requested by the trustees.

Such sum as may be deemed reasonable shall be allowed to the board of directors each year by the trustees to provide for the maintenance of the corporate organization of the company and the performance of such duties as may be necessary by the company and the directors.

SECTION 5. The Boston Elevated Railway Company shall, prior to or at the time of its acceptance of this act, provide for raising three million dollars in cash by the issue of preferred stock at not less than the par value which shall be one hundred dollars per share. *The issue of said stock shall not require the approval of the public service commission,* but if the remaining sections of this act fail to take effect as provided in section eighteen, such issue and the subscription thereto shall be null and void.

One million dollars shall be set aside as a reserve fund to be used for the purposes hereinafter specified, and the remaining two million dollars shall be subject to the disposition of the trustees to pay for the cost of additions and improvements to the company's property.

SECTION 6. The trustees *shall from time to time, in the manner hereinafter provided, fix such rates of fare as will reasonably insure sufficient income to meet the cost of the service,* which shall include operating expenses, taxes, rentals, interest on all indebtedness, such allowance as they may deem necessary or advisable for depreciation of property and for obsolescence and losses in respect to property sold, destroyed, or abandoned, all other expenditures and charges which under the laws of the commonwealth now or hereafter in effect may be properly chargeable against income or surplus, fixed dividends on all preferred stock of the company from time to time outstanding, and dividends on the common stock of the company from time to time outstanding at the rate of five per cent per annum on the par value thereof during the first two years, five and one half per cent per annum on the par value thereof during the next two years and six per cent per annum on the par value thereof during the balance of the period of public operation. Dividends upon the common shares shall be payable quarterly, but no dividends shall be paid upon such common shares in excess of the rates herein specified. The first payment shall be made at the expiration of six months from the commencement of public operation, and the total of the first three quarterly dividend payments shall be five per cent on the par value of the common stock.

SECTION 7. The trustees *shall, within sixty days after their appointment and qualification, fix and put in operation rates of fare which in their judgment will produce sufficient income to meet the cost of service* as

defined in section six, and within sixty days thereafter shall adopt and publish a schedule of eight different grades of fare above and below the existing rate of fare. above the rate of fare first established; and whenever by reason of any change in the existing rate of fare there are less than four grades, either above or below the rate then in force, the trustees shall forthwith adopt and publish a schedule of additional grades of fare so that there shall always be not less than four grades of fare above and below the existing rate of fare.

If at any time the trustees shall be of opinion that said rates of fare or schedule should be changed, either with regard to the method or basis upon which the fares and transfer privileges are established, or because the steps between the different grades are too small or too great, or for any other reason, the trustees may adopt, publish, and put in effect new schedules or rates of fare to take the place of the existing schedule or rates of fare.

SECTION 8. The reserve fund shall be used only for the purpose of making good any deficiency in income as provided in section nine or for reimbursing the commonwealth as provided in sections eleven and thirteen, and until such use, may be invested in income-producing securities in the discretion of the trustees, and all income or interest received thereon shall be treated as part of the general income of the company.

SECTION 9. Whenever the income of the company is insufficient to meet the cost of service as herein defined, the reserve fund shall be used as far as necessary to make up such deficiency, and whenever, on the other hand, such income is more than sufficient to meet the cost of the service, the excess shall be transferred to and become a part of the reserve fund.

SECTION 10. If, as of the last day of June in the year nineteen hundred and nineteen, or the last day of any September, December, March or June there-

after, the amount of the reserve fund shall exceed by thirty per cent or more the amount originally established, and during the preceding three months the income shall have exceeded the cost of the service, the trustees shall within one month thereafter put into effect the next lower grade of fare that has been adopted as provided in section seven; and if, as of any such last day of June, September, December or March, the amount of the reserve fund shall be less than seventy per cent of the amount originally established and during the preceding three months the income has been less than the cost of the service, the trustees shall within one month thereafter put into effect the next higher grade of fare, and the fare shall continue to be decreased or increased, as the case may be, subject to the same conditions, if the amount of the reserve fund is above or below said limits, as of such quarterly dates. In determining the amount of the reserve fund for the purpose of this section only, there shall first be deducted therefrom any amounts which have been paid by the commonwealth to the company under the provisions of section eleven, and for which the commonwealth has not been reimbursed.

SECTION 11. *If,* as of the last day of June in the year nineteen hundred and nineteen, or the last day of any December or June thereafter, *the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained.* Pending such payment it shall be the duty of the trustees to borrow such amount of money as may be necessary to enable them to make all payments, including dividend payments, as they become due. *If,* as of the last day of any June or December thereafter during the period of public operation, the *reserve fund shall*

exceed the amount originally established, the trustees shall apply the excess, so far as necessary, to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof, and the commonwealth shall thereupon distribute the amount so received among the cities and towns in which the company operates, in proportion to the amounts which they have respectively been assessed as provided in section fourteen.

In order to meet any payment required of the commonwealth under the provisions of this section the treasurer and receiver general may borrow at any time, in anticipation of the assessments to be levied upon the cities and towns, such sums of money as may be necessary to make said payments, and he shall repay any sums so borrowed as soon after said assessments are paid as is expedient.

SECTION 12. Notwithstanding anything contained in this act, the public management and operation of the railway system of the company shall continue after the expiration of said ten year period upon the terms and conditions herein specified until such time as the commonwealth shall elect to discontinue such public management and operation. The commonwealth shall have the right to terminate such public management and operation, either at the expiration of the said ten year period or at any time thereafter, by appropriate legislation passed not less than two years before the date fixed for such termination.

SECTION 13. It shall be the duty of the trustees to maintain the property of the company in good operating condition and to make such provision for depreciation, obsolescence and rehabilitation, that, upon the expiration of the period of public management and operation, the property shall be in good operating condition. *If the period of public management and operation expires,* control of the property shall then revert to the company, *and if at that time the reserve fund shall be*

less than the amount originally established because the income during the period of public management and operation has been insufficient to pay the cost of the service, the commonwealth shall forthwith pay over to the company an amount sufficient to restore it to its original amount and if the amount in said reserve fund is then in excess of the amout originally established and any amount required to meet the cost of the service to the expiration of such period, such excess shall be paid into the treasury of the commonwealth and distributed among the cities and towns in which the company operates in the same proportions as the assessments provided for by section fourteen.

SECTION 14. *In case the commonwealth shall be called upon to pay to the trustees or the company any amount under the provisions of sections eleven and thirteen, such amount* with interest or other charges incurred in borrowing money for the purpose *shall be assessed upon the cities and towns in which the company operates by an addition to the state tax next thereafter assessed in proportion* to the number of persons in said cities and towns using the service of the company at the time of said payment, *said proportion to be determined and reported to the treasurer and receiver general by the trustees from computations made in their discretion for the purpose.*

SECTION 15. Upon the termination of the period of public management and operation, the company shall manage and operate the property and may fix and collect such just and reasonable fares as will produce an income sufficient to pay the reasonable cost of the service as defined in section six, including dividends upon the common stock from time to time outstanding of six per cent per annum on the par value thereof but no more, and may establish schedules of fares which shall automatically increase or decrease in the same manner as is authorized in the case of the trustees: *provided,* that the commonwealth shall be under no liability to

make any payments to the company by reason of any deficiencies in income accruing after the discontinuance of public operation. The company shall thereafter be subject to public regulation and supervision in such manner as may be determined by the general court, but such regulation and supervision shall not be exercised so as to reduce the income below the reasonable cost of the service as defined in this act.

APPENDIX C.

The following excerpts appear to be the principal judicial summaries of the legislation administered by the petitioners:

"We consider first Spec. St. 1918, c. 159. That act was in substance and effect a taking over of the Boston Elevated Railway by the Commonwealth for operation for a limited period of ten years and possibly for a longer period under some circumstances. . . . The chief design of that act was to provide by public operation for fares at rates sufficient to meet all costs of furnishing the service.

"Under modern conditions local transportation by an electric railway may be determined by the Legislature to concern the welfare and convenience of all the inhabitants of a particular district. In essence Spec. St. 1918, c. 159, was a legislative agreement for the lease to the Commonwealth of a public utility to be operated for a limited time by public officers upon the payment of fair rental on an investment made under public supervision and under laws prohibiting stock watering or other means of inflation.

"The fundamental question is whether the General Court has the right to authorize the operation of the Boston Elevated Railway Company through the trustees appointed by the Governor. It can do so if it is a public purpose. If it is a public purpose, the General Court has the same power respecting that purpose that it has respecting other purposes. Since transportation of the public such as is furnished by the Boston Elevated Railway is a public purpose, there is no imperative constitutional requirement that it must be operated by the public authorities at cost or at a profit."

Opinion of the Justices, 231 Mass. 603, 607-8, 609, 612.

"That act provides for public operation of the railway through a board of five trustees appointed by the Governor, who 'shall manage and operate the Boston Elevated Railway Company . . . and the properties owned, leased or operated by it, for a period of ten years,' and thereafter upon the same terms until such time as the Commonwealth shall elect to discontinue public management and operation, and who, subject to the provisions of the act, 'shall take and have possession of said properties in behalf of the Commonwealth,' with 'the right to regulate and fix fares,' transfers and other charges, and to 'determine the character and extent of the service and facilities to be furnished.' The railway company is required to raise $3,000,000 by the issuance of preferred stock with dividends not to exceed seven per cent, for the improvement of the property of the company and the establishment of a reserve fund. The trustees are directed to 'fix such rates of fare as will reasonably insure sufficient income to meet the cost of the service, which shall include operating expenses, taxes, rentals, interest on indebtedness, such allowance as they may deem necessary or advisable, for depreciation of property and for obsolescence and losses,' fixed dividends on preferred stock and dividends on the common stock at the rate of five per cent for the first two years, five and one-half per cent for the next two years and six per cent for the remainder of the period of public operation. If there is a deficiency between the cost of operation as thus defined and the receipts, the trustees are required to notify the Treasurer and Receiver General and the Commonwealth shall thereupon pay the amount of the deficit ascertained according to the act. The trustees are required to maintain the property of the railway company in good operating condition and to make such provision for depreciation, obsolescence and rehabilitation;

that upon the expiration of the period of public management, the property shall be 'in good operating condition,' and shall then revert to the railway company. In case the Commonwealth is called upon to make payments to the trustees to meet deficits or diminution of the reserve fund provided for in the act, such amounts shall be assessed upon the several cities and towns in which the railway company operates by addition to the State tax next thereafter assessed in proportion to the number of persons in said cities and towns using the service of the company at the time of the payments as determined by the trustees. The act contains provision for acceptance by stockholders of the Boston Elevated Railway Company, and of the West End Street Railway Company, but not by the city of Boston; that none of its provisions shall be construed to constitute a contract binding on the Commonwealth except those which define the terms and conditions under which the property shall be managed and operated by the trustees and the provisions of Sec. 13 relating to the upkeep of the railway company's property.

"Some analysis of the provisions of Spec. St. 1918, c. 159, is necessary in order to deal with the contentions that it is unconstitutional. Its general scope is indicated by its title, which is, 'An Act to provide for the public operation of the Boston Elevated Railway Company.' The accuracy of the title is confirmed by the substance of the act throughout. Its purpose is operation through public officers and not public ownership. . . . In essence this act, having been accepted by the railway companies, constitutes an agreement between th Boston Elevated Railway Company and the Commonwealth that the latter shall take over the management and operation of the railway company and shall pay therefor the amounts specified in way of compensation for the use thereof. The

public operation is undertaken by the Commonwealth, not as a source of profit, but solely for the general welfare. The main design of the act is public operation of the railway company at such rates of fare to be fixed by the trustees from time to time as shall afford revenue sufficient to defray all charges and the dividends established by the act.

"The Commonwealth, acting through the General Court, has the constitutional power to assume the management and operation of the Boston Elevated Railway Company system. The reasons may be stated briefly. It is matter of common knowledge that the passenger transportation service for Boston and its suburbs is chiefly by the means afforded by that system through lines of electric railways on the surface, by elevated structures and through tunnels and subways. Under modern conditions the nature of that transportation system as to adequacy, efficiency, speed, safety, comfort and expense and in other respects relates to the accommodation of the public and concerns the public welfare. There is no distinction in principle between the management and operation of such a transportation system by a public agency established by the Legislature and the taking over by counties, cities and towns of toll bridges and turnpikes, originally private enterprises. The validity of such takings is settled.

"It is matter of common knowledge, and has come to the attention of the court in cases to be decided, that the period after the opening of the Great War and at the time of the passage of this act was one of extraordinary difficulty and abnormal conditions for the operation of street railways."

Boston v. *Treasurer & Receiver General*, 237 Mass. 403, 410-11, 411-14, 416.

"The operation and management of the Boston Elevated Railway Company during the term of the lease are to be by a board of public officers for the promotion of the general welfare, although at the same time provision is made for the conservation of the private interests of the owners of the railway company."

Opinion of the Justices, 261 Mass. 523, 542.

"The railway company got into financial difficulty. It served the residents of Boston and other towns of the commonwealth. The general court, in the public interest, passed the special Act of 1918 to relieve the situation. In general the act provided for the appointment of trustees, who were to take the railway out of the hands of the company and operate it under the leases to the company by the city of Boston, on condition that the stockholders of the railway company accepted the provisions of the act. It is not necessary to set out what these provisions in detail are, except to say that they provide for the payment of dividends on the stock of the company, the repair and maintenance of the railway, the raising of $3,000,000 by the company for the improvement of the property and a reserve fund, and the payment of any deficit in operation out of the treasury of the commonwealth. If the commonwealth is called upon to make payments to meet deficits or diminution of the reserve fund, such amounts are to be assessed upon the several cities and towns in which the railway operates, as an addition to the regular state tax, in proportion to the number of persons in said cities and towns using the service of the company at the time of the payments, as determined by the trustees. The trustees are to fix the fares to meet the cost of service, including taxes, rentals, and interest on the indebtedness of the company, fixed

dividends on the preferred stock, and 5 per cent on the common stock for two years, 5½ per cent for the next two years, and 6 per cent for the remainder of public operation, which is for a period of ten years, and thereafter as the Commonwealth shall determine."

Boston v. *Jackson*, 260 U. S. 309, 311-12.

APPENDIX D.

The following cases would seem to indicate that even since *Flint* v. *Stone Tracy Company,* 220 U. S. 107, 172, the providing of means of transportation may have been viewed generally as an "essential governmental function."

In *Jamestown & Newport Ferry Company* v. *Commissioner,* 41 Fed. (2d) 920 (C. C. A. 1st), a ferry corporation, wholly owned by a municipality, was held to be an agency for the performance of an essential governmental function and not subject to an income tax. It is true that Sec. 213 (*b*) (7) of the Revenue Acts of 1921 and 1924 was involved, but the court did not seem to feel that the language of that section was necessarily decisive, for it placed considerable emphasis on the constitutional exemption itself.

In *United States* v. *King County,* 281 Fed. 686 (C. C. A. 9th), it was held that the Federal transportation tax could not apply to a ferry, maintained and operated by a county.

In *Frey* v. *Woodworth,* 2 Fed. (2d) 725 (D. C. E. D. Mich. S. D.), it was held that the salary of an employee of a municipally owned and operated street railway was not subject to the Federal income tax. The government sued out a writ of error which later, on the motion of the Solicitor General, was dismissed with costs. 270 U. S. 669.

See also *Moisseiff* v. *Commissioner,* 21 B. T. A. 515, involving the salary of an employee of the Delaware River Bridge Joint Commission and the Port of New York Authority.

On the other hand, the following decisions seem distinguishable:

In *City of Seattle* v. *Poe,* 4 Fed. (2d) 276 (D. C. W. D. Wash. M. D.), the court merely held that the case was not one for the issuance of an injunction against the collections of taxes.

In *Lyons* v. *Reinecke,* 10 Fed. (2d) 3 (C. C. A. 7th), relating to the compensation of an employee of the Board of Local Improvements of the City of Chicago, the declaration was held to be too vague and uncertain. (*Id.* page 7.) Further, the whole theory of the statute was that the improvements should be "of local concern, a local benefit, that may be stopped or postponed by a majority of the frontage involved." (*Id.* page 6.) Such discussion as there is of the distinction between governmental functions and business of a private nature is not particularly satisfactory.

In *Blair* v. *Byers,* 35 Fed. (2d) 326 (C. C. A. 8th), the salary of the counsel for the "Board of Water Works Trustees" of the City of Des Moines was held taxable. The tax related to years which were subject to Section 1211 of the Act of 1926 and the taxpayer was held not to have become an officer or employee within the meaning of the statute. The Court did say that "the building and operation of a water works system by municipalities constitutes the exercise of a proprietary, rather than a governmental function." (*Id.* page 327.) Reliance was, however, placed upon quotations from *South Carolina* v. *United States* and from *Flint* v. *Stone Tracy Co.,* without adequate analysis of what those cases actually decided.

In *Cleveland Railway Co.* v. *Commissioner of Internal Revenue,* 36 Fed. (2d) 347 (C. C. A. 8th), the income of a company operating a street railway system was held subject to tax in its entirety notwithstanding that its excess income over certain dividend requirements had to be made the basis of reduced fares in succeeding years. This decision is fairly within the scope of *Flint* v. *Stone Tracy Co.* The petitioner was a privately owned corporation; the city owned no part of its capital stock, derived no income from the operation of its business and paid no part of its expenses; therefore the tax could not fall upon the city or interfere with its governmental functions. (*Id.* page 349.)

SUPREME COURT OF THE UNITED STATES.

No. 17.—October Term, 1934.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Leland Powers, Executor, et al.	On Writ of Certiorari to the United States Circuit Court of Appeals for the First Circuit.

[December 3, 1934.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The question presented is whether the compensation of the members of the Board of Trustees of the Boston Elevated Railway Company is constitutionally exempt from the imposition of a federal income tax. Immunity is sought upon the ground that the trustees are officers of the Commonwealth of Massachusetts and instrumentalities of its government. The Circuit Court of Appeals, reversing the decision of the Board of Tax Appeals, held in favor of the exemption. 26 B. T. A. 1381; 68 F. (2d) 634. We granted a writ of certiorari. 292 U. S. 620.

Chapter 159 of the Massachusetts Special Acts, 1918, provides for the public operation of the Boston Elevated Railway Company. The Act creates a board of five trustees, to be appointed by the Governor, with the advice and consent of the Council, for the term of ten years. The Act provides that the trustees shall be sworn before entering upon their duties; they shall own no stock or other securities of the Company and shall each receive from the Company $5,000 annually as compensation for his services. They are subject to removal by the Governor with the advice and consent of the Council.

The trustees are charged with the duty of managing and operating the Company and its properties for the period, as stated or extended, of public operation, and to that end are to have "possession of said properties in behalf of the Commonwealth". Except as otherwise stated, they are to exercise all the powers of the Company, being empowered in their discretion to appoint and remove the

president and other officers of the Company, except the directors. The trustees are authorized "to regulate and fix fares" and "to determine the character and extent of the service and facilities to be furnished". Their authority for this purpose is made "exclusive" and is not "subject to the approval, control or direction of any other state board or commission". The Act provides that the trustees and their employees shall be deemed to be acting as agents of the Company and not of the Commonwealth, and that the Company shall be liable for their acts and negligence to the same extent as if they were in the immediate employ of the Company, but that the trustees shall not be personally liable.

The Company was required, on or before its acceptance of the Act, to raise a stated amount by the issue of preferred stock in order to provide for the improvement of the property of the Company and the establishment of a reserve fund. The trustees are to fix such rates of fare as will reasonably insure sufficient income to meet the cost of service, as defined, which, in addition to operating expenditures, outlays for the required upkeep of the properties, and other amounts chargeable against income and surplus, includes fixed dividends on the preferred stock and dividends on the common stock at specified rates. Surplus income is to be transferred to the reserve fund and that fund is to be used to meet deficiencies. If it is insufficient for that purpose, the trustees are required to notify the treasurer and receiver general of the Commonwealth, and the Commonwealth is to pay the amount of the deficit ascertained according to the Act. Amounts thus paid are to be assessed upon the several cities and towns in which the Company operates. Provision is made for reimbursement out of subsequent surplus income. The Act contemplates the maintenance of the property in good operating condition and the restoration of the reserve fund, if depleted, to its original amount on the expiration of the period of public management. At that time the control of the property is to revert to the Company. It may then collect such reasonable fares as will produce an income sufficient to pay the reasonable cost of the service as defined in the Act, including specified dividends on the common stock, and the Company is then to be subject to public regulation in such manner as may be determined by the General Court, but not so as to reduce the income below the cost of the service as stated.

The tax in question was on the compensation received by the trustees for the years 1926 to 1929. It appears that in 1919 the Commonwealth paid to the Company nearly $4,000,000 as a deficiency resulting from the public operation, and that in subsequent years, up to and including 1929, the income received was not sufficient for full reimbursement.

The validity of the statute has been sustained as one enacted for a public purpose and providing for the management of the enterprise by the Commonwealth. *Boston* v. *Treasurer & Receiver General*, 287 Mass. 403, 413, 420; *Boston* v. *Jackson*, 260 U. S. 309, 314, 316. The Supreme Judicial Court of Massachusetts has characterized the "public operation" as "undertaken by the Commonwealth, not as a source of profit, but solely for the general welfare". *Boston* v. *Treasurer & Receiver General, supra.* The trustees are the administrative agents of the Commonwealth in this enterprise, and we may assume, as the Circuit Court of Appeals has held, that the trustees come within the general category of "public officers" by virtue of their appointment by the Governor, with the advice and consent of the Council, and their tenure and duties fixed by law.[1] *United States* v. *Hartwell*, 6 Wall. 385, 393; *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 520. See *Opinion of the Justices*, 261 Mass., pp. 542, 543, 550.

While the undertaking is for the public benefit, it is still a particular business enterprise—the operation of a street railway—and the functions of the trustees are limited accordingly. The property remains in private ownership. The Act, accepted by the Company, constitutes in substance an agreement between the Company and the Commonwealth that the latter shall temporarily take over the management and operation and pay specified amounts by way of compensation. While the Commonwealth may be called upon to bear losses that may occur, if the fares as fixed prove to be insufficient, the operation by the trustees is intended to be self sustaining. The transportation service is to be rendered, as respondents' counsel say, "under such a flexible

[1]The provision of Section 1 of Chapter 159 of the Massachusetts Special Acts of 1918 that the trustees shall not be considered public officers within the meaning of Section 25 of Chapter 514 of the Acts of 1909, and that Section 1 of Chapter 7 of the Revised Laws shall not apply to the trustees, creates special limitations of such a nature as not to derogate from their general status. See Opinion of the Justices, 261 Mass., p. 543.

system of rate-making as would allow the fixing of fares equal, as nearly as might be, to the cost of service." The compensation of the trustees is undoubtedly a part of that cost. "The main design of the Act", as stated by the Supreme Judicial Court, "is public operation of the railway company at such rates of fare to be fixed by the trustees from time to time as shall afford revenue sufficient to defray all charges and the dividends established by the act". *Boston* v. *Treasurer & Receiver General, supra.* The authority given to the trustees "to regulate and fix fares", and the further authority to ascertain such losses as may be incurred, which are to be borne by the Commonwealth, are both incident to that main purpose.

The immunity sought by the trustees from payment of the federal income tax has not been granted by the Congress. The definitions of income in the federal income tax acts cover income derived "from compensation for personal service . . . of whatever kind and in whatever form paid". Revenue Acts of 1926, secs. 212 (a), 213 (a); 1928, secs. 21, 22 (a). This language is certainly broad enough to embrace the compensation of the trustees, and the immunity, if it exists, must rest upon constitutional limitation. The Treasury Regulations, manifestly in an effort to interpret and apply that limitation, provide for exemption from taxation of compensation paid by a State or political subdivision to its officers and employees only in case their services are rendered "in connection with the exercise of an essential governmental function". Treas. Reg. No. 69, Art. 88; No. 74, Art. 643; No. 77, Art. 643. But the Treasury Department could not by its regulation either limit the provisions of the statute or define the boundaries of their constitutional application.

We come then to the question whether the Congress has the constitutional power to impose an income tax upon the compensation of public officers of the character here involved. We do not regard that question as answered by mere terminology. The roots of the constitutional restriction strike deeper than that. The term "public office" undoubtedly implies a definite assignment of public activity, fixed by appointment, tenure and duties. But whether that field of activity in relation to a State, carries immunity from federal taxation is a question which compels consideration of the nature of the activity, apart from the mere creation of offices for conducting it, and of the fundamental reason for denying federal

authority to tax. That reason, as we have frequently said, is found in the necessary protection of the independence of the national and state governments within their respective spheres under our constitutional system. *Collector* v. *Day*, 11 Wall. 113, 125, 127; *Ambrosini* v. *United States*, 187 U. S. 1, 7; *Indian Motocycle Company* v. *United States*, 283 U. S. 570, 575. The principle of immunity thus has inherent limitations. *Metcalf & Eddy* v. *Mitchell*, *supra*, pp. 522-524; *Willcuts* v. *Bunn*, 282 U. S. 216, 225, 226; *Indian Motocycle Company* v. *United States*, *supra*, p. 576; *Fox Film Corporation* v. *Doyal*, 286 U. S. 123, 128; *Board of Trustees* v. *United States*, 289 U. S. 48, 59. And one of these limitations is that the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the federal taxing power would normally extend. The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity. *South Carolina* v. *United States*, 199 U. S. 437; *Flint* v. *Stone Tracy Company*, 220 U. S. 107, 172; *Murray* v. *Wilson Distilling Company*, 213 U. S. 151, 173; *Metcalf & Eddy* v. *Mitchell*, *supra*; *Indian Motocycle Company* v. *United States*, *supra*; *Ohio* v. *Helvering*, 292 U. S. 360, 368, 369. The necessary protection of the independence of the state government is not deemed to go so far.

In *South Carolina* v. *United States*, *supra*, the State undertook to establish a monopoly of the sale of intoxicating liquors and prohibited the sale except to dispensaries to be operated by the State. The dispensers had no interest in the sales and received no profit from them. The question was whether the dispensers were relieved from liability for the internal revenue tax prescribed by the Congress for dealers in intoxicating liquors because the dispensers were agents of the State, which in the exercise of its sovereign power had taken charge of the business. While the court recognized the power of the State to undertake the enterprise, the exemption was denied, as the State could not, by engaging in a business of that sort, withdraw it from the taxing power which the Constitution vested in the national government. *Murray* v. *Wilson Distilling Company*, *supra*.

The Court reached a similar conclusion in the recent case of *Ohio* v. *Helvering, supra*, where the State had established a department of liquor control and sought an injunction to restrain the enforcement of federal statutes imposing taxes upon dealers in intoxicating liquors. The State sought to distinguish the case of South Carolina because, in Ohio, "the state-owned stores" were operated by civil service employees of the state government, and hence the question was said to concern the taxation of the State itself. The argument was unavailing and the Court rested its ruling upon the broad ground that when the State becomes a dealer in intoxicating liquors it falls within the reach of the tax as one validly imposed by the federal statute.

The method which the State may adopt in organizing such an activity cannot be regarded as determinative. If the dealers in South Carolina, or those employed to operate the state stores in Ohio, had been denominated public officers, and as such had been assigned definite tenure and duties, the same result would have been reached, as the principle involved would be equally applicable. Nor, in such a case, would the fact that the officers were entrusted with the authority to fix prices for the sales under their charge in a manner appropriately to secure the revenue needed for the enterprise, or were charged with the duty of ascertaining the losses which, if they occurred, were to be borne by general taxation, establish a material distinction. The nature of the enterprise, and not the particular incidents of its management, would control.

We see no reason for putting the operation of a street railway in a different category from the sale of liquors. In each case, the State, with its own conception of public advantage, is undertaking a business enterprise of a sort that is normally within the reach of the federal taxing power and is distinct from the usual governmental functions that are immune from federal taxation in order to safeguard the necessary independence of the State. If, in the instant case, the Commonwealth had acquired the property of the Company and had organized management of it in perpetuity by the state government, instead of temporarily, or had taken over all the street railways in all its cities for direct operation by the Commonwealth, there would appear to be no ground, under the principles established by the decisions we have cited, for holding that this would effect the withdrawal of the enterprise from the federal taxing power. And the fact that the State has here under-

taken public management and operation for a limited time, and under the particular restrictions of the agreement with the Company, cannot be said to furnish a ground for immunity.

If the business itself, by reason of its character, is not immune, although undertaken by the State, from a federal excise tax upon its operations, upon what ground can it be said that the compensation of those who conduct the enterprise for the State is exempt from a federal income tax? Their compensation, whether paid out of the returns from the business or otherwise, can have no quality, so far as the federal taxing power is concerned, superior to that of the enterprise in which the compensated service is rendered.

We conclude that the Congress had the constitutional authority to lay the tax.

Decree reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.